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International Financial Situation Report

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Issue 69

22 October 1987

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Central Intelligence Agency



Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #69 22 October 1987

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Summary

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will continue to deteriorate,

the LDC debt issue

the current debt strategy of periodic refinancing would likely end if new money requirements exceed LDC debt servicing payments, loan conditionality is abandoned, debt negotiations become even more lengthy and tiresome, or if a general system collapse of the current debt strategy—caused by the actions of a major debtor—were to threaten their own interests. In other developments:

Negotiations are continuing this week between Brasilia and its Bank Advisory 0 Committee (BAC), but the two sides remain far apart on basic issues surrounding a multiyear debt rescheduling and new money package. Brasilia's principal debt negotiator, Fernao Bracher, presented the BAC a timetable for debt negotiations on 16 Ocother that calls for an agreement on a term sheet with the BAC by 15 November, a full accord with all creditor banks by 15 December, and the resumption of interest payments by 31 December.

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- President Alfonsin announced tough austerity measures last week in a bold move to 0 satisfy creditors, reassert political authority following his electoral setback last month, and regain the momentum of his 1985 Austral Plan. Some of the proposalsincluding major increases in the country's low minimum wage and in retirement benefits, and new rules for revenue sharing with the provinces-indicate extensive prior consultations with the Peronists that will probably smooth passage of enabling legislation through Congress. Other aspects, however, such as the stiff increase in public-sector tariffs and the probably quick disregard of Argentina's third price freeze in 28 months, will almost certainly generate labor unrest.
- President Aquino has publicly directed her representatives to consumate the debt rescheduling accord with Manila's commercial creditors prior to 15 November. Although obstacles remain and timing is critical, conclusion of the current agreement is sufficiently in Manila's interest and resolution is likely. Even if the agreement is signed, however, the Philippine's \$29 billion foreign debt will remain an issue in 25X1

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DEVELOPMENTS IN MAJOR COUNTRIES

Brazil

Negotiations are continuing this week between Brasilia and its Bank Advisorv Committee (BAC), but the two sides remain far apart on basic issues surrounding a multiyear debt rescheduling and new money package. Brasilia's principal debt negotiator, Fernao Bracher, presented the BAC a timetable for debt negotiations on 16 October that calls for an agreement on a term sheet with the BAC by 15 November, a full accord with all creditor banks by 15 December, and the resumption of interest payments by 31 December. Brasilia has not modified its initial proposals of \$10.4 billion for interest refinancing with no linkage between disbursements and IMF performance criteria and an automatic interest capitalization scheme, however, which bankers previously rejected, making it highly unlikely Brasilia's proposed schedule can be met.				
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Argentina

President Alfonsin announced tough austerity measures last week in a bold move to satisfy creditors, reassert political authority following his electoral setback last month, and regain the momentum of his 1985 Austral Plan. The initiative combines new structural reforms and general belt tightening with stopgap measures. The elimination of fixed interest rates, introduction of a new floating exchange rate for financial transactions, and reduction in matching funds required to exchange debt for equity are novel steps for the Alfonsin administration and should please bankers. The government's efforts to raise taxes, boost the real prices of public-sector goods, and cut parastatal expenditures appear, in our view, to be more serious than past attempts and, if fully implemented, would significantly reduce the fiscal deficit. The program's price and wage freeze, an involuntary "savings" plan, and continued government regulation of export-

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related exchange rates are, however, shopworn measures that have alienated businessmen and harmed the Argentine economy over the long run. 25X1 Some of the proposals-including major increases in the country's low minimum wage and in retirement benefits, and new rules for revenue sharing with the provincesindicate extensive prior consultations with the Peronists, which will probably smooth passage of enabling legislation through Congress. Other aspects, however, such as the stiff increase in public-sector tariffs and the probably quick disregard of Argentina's third price freeze in 28 months will almost certainly generate labor unrest. We therefore believe there is a high potential for backsliding-by, for example, letting real prices for parastatal services deteriorate, reasserting control over interest rates, or failing to make sufficient cuts in parastatal expenditures. 25X1 Argentina received some badly needed positive news on the balance-of-payments front this month. Commercial banks disbursed the first \$750 million tranche from their \$1.95 billion new money package, Japan announced a \$737 million loan to the petrochemical and energy sectors, and the US Government announced it will participate in a \$500 million bridge loan for Argentina. We believe, moreover, that the new economic plan will probably induce the IMF to release the next \$213 million portion of its standby loan next month. Given the limited prospects for export improvement next year, however, the external-account situation will remain shaky. The US Embassy reports that Buenos Aires has allowed some new Paris Club arrearages to accumulate, and we estimate that Argentina may need to seek an additional \$1.0 billion in fi_{25} X1 ing from the international community next year. Philippines 25X1 President Aquino has publicly directed her representatives to consumate the debt rescheduling accord with Manila's commercial creditors prior to the 15 November deadline. Although obstacles remain and timing is critical, conclusion of the current agreement is sufficiently in Manila's interest and resolution is likely. agreement is not reached before the deadline, the Philippines would lose \$94 million in retroactive interest payments. 25X1 The major remaining issue of the agreement is the question of Philippine 3 25X1

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Government responsibility for payment of the \$56 million Planters Product Inc. (PPI) loan. About 30 of 483 commercial banks have held off signing the rescheduling accord pending the final settlement of the PPI loan. According to the US Embassy, Finance Secretary designate Jayme will seek agreement with the banks to a Philippine Congressional proposal where Manila would pay PPI \$20 million in previously committed subsidies and then let the company negotiate with its creditors.	25X
Although final agreement on the PPI loan probably cannot be reached by the 15 November deadline, the banks may agree to an extension if they believe Manila is earnestly working for a settlement. Even if the agreement is signed, however, the Philippine's \$29 billion foreign debt will remain an issue in Manila. The political and economic pressue that has been building in the Philippines for debt relief is likely to be vented early next year, probably including requests for new money or interest capitalization or both along with a government-to-government approach to the debt.	25X1
Other Latin American Countries	
In Latin America, Venezuela's commercial debt accord remains on hold, Ecuador and its commercial creditors reached a preliminary rescheduling agreement, and Peru faces obstacles to clearing up it debt arrearages.	25X
Venezuela	
Venezuela's \$21 billion public sector rescheduling agreement remains on hold due to the reluctance of several commercial banks to sign. As of mid-October, banks holding 80 percent of the rescheduled debt have signed. The Bank Advisory Committee has unofficially extended the deadline for signature to 15 November 1987. concern about unresolved debt arrearages with individual Venezuelan state enterprises, caused by bureaucratic delays, has resulted in some banks refusing to sign the accord. We expect that all banks will sign the agreement by mid-November.	25X1 25X 25X1
Meanwhile, Venezulean officials are stepping up their efforts to obtain project and trade financing from private banks and official sources. Several major US banks have expressed interest in financing Venezuelan investment projects, particularly those involved in export diversification, and have tacitly approved increasing trade credit lines. Caracas is also involved in talks with the World Bank to obtain \$450 million in trade policy support loans, according to the US Embassy. Meanwhile, in a move apparently calculated to reduce inflationary pressures and attract foreign financing, Caracas has revised its 1988 budget to reduce its projected deficit by 38 percent and to limit outlays for public sector projects by one fifth.	[—] 25X 25X
Ecuador	
Ecuador is making progress in debt negotiations with multilateral creditors and commercial banks, but faces a tough road ahead in efforts to reschedule its debt before the presidential elections in January 1988. Quito and its Bank Advisory Committee (BAC) have devised a preliminary rescheduling agreement, which, if President Febres-Cordero approves, will be presented to all creditor banks.	25X1
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The agreement stipulates that Ecuador must resume interest paym 15 November and all interest arrearages must be made up before new disbursed. In addition, the BAC requires that both an IMF-supported progexport financing facility be in place before the agreement goes into effect. the administration is planning a tighter control over the economy next year—budget proposal projects the public-sector deficit at less than 1 percent of Githat is likely to improve Ecuador's prospects for an IMF standby agreement.	w money is ram and oil Meanwhile,
Peru	
Lima's ongoing attempts to ease tensions with its foreign creditors access to foreign lending are unlikely to move beyond the discussion stage to continuing decline in foreign exchange reserves will not allow the government payment arrearages. In addition, in order to avoid sharp criticism from President Garcia would have to demonstrate that Peru would become a net reare foreign lending, a condition that will be difficult to meet given the size arrearages. Senior economic advisor, Daniel Carbonetto, who had met with and US officials in September to find a way of achieving a rapprochement creditors, has turned to four West European countries—including Spain Netherlands—for \$120 million to cover Peru's World Bank arrearages This suggests that Garcia wants to avoid further foreign exchange holdings. According to official figures, net foreign reserves to \$650 million at the end of August	to clear its to clear its the left, recipient of se of Peru's World Bank with Peru's n and the
Panama With a growing concern over the nation's finances, President Delvalle and 7 October an economic austerity package as part of a major cabinet de According to the US Embassy, the government announced its intention budgetary controls, freeze government seleries and new arrelation to budgetary controls, freeze government seleries and new arrelation.	eclaration.
budgetary controls, freeze government salaries and new employment, and insubank accounts, although it has issued no rules implementing these decisions. The administration, however, failed to announce new measures to offset declines in from the lower collection of import duties and value added tax—resulting deepening economic contraction. According to the US Embassy, these action viewed as steps in the right direction, but are insufficient to address the government problem of financing the revenue shortfalls expected for 1987. With a continuing lack of available credit from international creditors, we be an apparent slowdown in capital flight.	re private he Devalle revenues- from the ons can be ne critical and 1988.
USSR/Eastern Europe	
The Soviet Union continues to plan implementation of financial reforms. I Europe, Yugoslavia probably will halt principal repayments until debt negotia completed, and East Germany turned to Bonn for financial assistance.	n Eastern ations are

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Yugoslavia			
from 40 to 25 percent, due in the next three principal repayments to 1.7 percentage points probably will halt printhrough the rest of the already been postponed reporting. In initial oversight because it concessions to credito probably will be willing or a multiyear IMF Ex	confront its creditors next mubmit to IMF oversight in revenue yugoslavia hopes to resched yugoslavia hopes to resched years, extend rescheduling antil at least 1990, and lower above LIBOR to 0.7 perceptional repayments until negoes year amount to \$340 millionary and \$170 million to officional debt talks, the Mikulic ghas staked its political resched from Facility—to averse a condition for Western files.	dule previously resche g periods to at least er interest-rate sprea entage point above L tiations are complete on to banks—\$250 mil ial creditors, according government probably survival largely on world Bank structural	debt service ratio duled debt falling to 15 years, delay ds from a high of MBOR. Belgrade d. Payments due lion of which has ag to US Embassy will reject IMF avoiding major entually Belgrade

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		25
	Asia	•
	China	
	The Bank of China (BOC) officially entered the London Euromarket last week with a \$200 million floating rate note issue. The issue was tightly priced, as has become the hallmark of Chinese issues, at 0.06 percentage point above LIBOR.	
		25
(the US Embassy, BOC's foreign exchange department—a key department in Beijing's relations with the international financial community—is extremely interested in diversifying its funding sources and expects to be back in the Euro and US markets on a regular basis. Meanwhile, China received its first loan for \$100 million from the Asian Development Bank	25
L	Africa	
	Nigeria	
	In an effort to conclude its longstanding trade arrears problem, Nigeria issued a new proposal on 22 September for the payment tersm of \$3 billion in promissory notes. According to the US Embassy, the guidelines propose interest rate capitalization—at 1 percentage point over LIBOR—on the notes due and unpaid up to 5 January 1988. After that time, fixed payments will be made on a quarterly basis over the next 22 years. In addition, the Central Bank announced it will cease processing new claims on trade arrears, although it will continue to approve and issue promissory notes for claims already reconciled. This proposal provides an effective annual yield of 5.7 percent, higher than Nigeria's last offer of 4 percent, but not as high as the noteholders would like. The estimated 6,500 noteholders are expected to discuss these terms in a mid-November meeting according to press reporting. More recently, the bilateral rescheduling agreement with Germany, was not signed in early October, despite press reports, because Finance Minister Okongwu sought additional changes at the signing ceremony.	25X

FINANCIAL BRIEFS

Americas

Costa Rican IMF standby will be received by Executive Board by 28 October discussions with World Bank on second structural adjustment loan well advanced, would include public finance, banking, and agricultural reforms bank talks postponed until 30 October, although San Jose believes prospects good for agreement in early 1988.	
Dominican Republic continues to balk at standby arrangement, fearing an increase in social unrest or loss of national sovereignty however, Santo Domingo may be willing to sign an IMF agreement if they could call it another name.	25X1
Nicaraguan Central Bank formulating economic stabilization plan to increase production program to include devaluation, export incentives, and price and salary freeze government may find plan politically unacceptable, would dilute many sections if adopted to avoid public outcry.	
Commercial banks have pledged \$700 million of Colombia's \$1 billion loan	25X1
Europe	
Hungary received a \$540 million government-backed loan from Bonn to meet 1987 financing needs next year's \$3 billion financing requirements will be harder to cover due to lower reserves and Western bank resistance to new loan requests Budapest plans to request IMF standby to help meet 1988 payments.	
Africa/Middle East	25 X 1
Affica/ Middle East	
Angola to submit IMF membership application this month also implementing IMF-style program, including devaluation, reduction of some subsidies, and limited privitization as prelude to application many Paris Club governments have expressed a willingness to reschedule all principal and interact.	25X1
willingness to reschedule all principal and interest with a six year repayment term.	25 X 1
Kenya instituted this month new regulations to ensure repatriation of all foreign exchange revenues reacting to balance-of-payments crisis, fall in foreign-exchange reserves, and banking scandal resulted in more stringent controls on economy.	
Commercial banks and Morocco signed rescheduling agreement on 23 September	25 X 1
and 3/16 over LIBOR completion keeps Rabat under compliance with IMF standby	25 X 1
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	25 X 1

Sudan implemented unification, placed balancing budget	nented its inform Price increases, Sporadic protes	nal IMF program parastatal reform	3 October step	s include exchange
·	ed 30 September	IMF standby tar	get on net credit	to the government
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